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DEPT FOR EEB/IFD/OMA AND EEB/EPPD

E.O. 12958: N/A
TAGS: EFIN ECON SZ
SUBJECT: UPDATE OF SWISS RESPONSE TO FINANCIAL CRISIS

REF: A. BERN 544
¶B. BERN 546
¶C. BERN 552
¶D. EMAIL L.FRERIKSEN/J.KESSLER RE: ECONOMIC MATRIX INPUT 10/23/08

¶1. Summary. Switzerland's economic outlook has steadily declined over the past three months with negative growth forecasts, increased unemployment, and industrial sectors starting to show the signs of stress. Despite the economic downturn, bank lending practices have not been impacted. The GOS has taken several actions to stem the recent economic and financial downturn, including a relaxation of monetary policy, and implementation of its UBS rescue package (Ref A). Following a public initiative, the GOS will further regulate bank executive salaries. The GOS restructured capital and leverage ratio regulations and is in the process of introducing liquidity ratio regulations to lessen the impact of future financial downturns. End Summary.

Economic Outlook Deteriorates

¶2. The Swiss outlook and economic projections have steadily declined over the past three months. The GOS altered growth forecasts from a marked slowdown with very low growth in 2009 to a forecast of negative 0.8 percent GDP growth for all of ¶2009. With the exception of consumption, all demand components are expected to decline. The KOF Swiss Economic Institute's economic growth barometer, which measures the economy's likely performance for the next six months, reached a five year low. Unemployment rates climbed from 2.5 percent in October to 2.7 percent in November and to 3.0 percent in December, and is expected to rise further to near 4.0 percent by late 2009. Many industry sectors are beginning to show signs of the economic crisis, although a few sectors are still posting positive sales.

¶3. Lending practices continue to hold in Switzerland. The Swiss National Bank (SNB) conducted regular surveys of 20 major Swiss banks to follow lending patterns. The SNB reports that in the vast majority of institutions surveyed, no lending restrictions were announced in the third quarter of 2008. Only 15 percent of banks reported that lending practices had become slightly more restrictive.

¶4. While the SNB continues to monitor the economic outlook, SNB officials and State Secretary for Economic Affairs Jean Daniel Gerber cautioned through press releases that it is hard to predict the impact of the financial crisis on Switzerland until there is greater certainty regarding the U.S. economy.

Relaxation of Monetary Policy

¶5. Since reftel reporting on the financial crisis, the GOS

continues to react to an increasingly negative economic outlook, even though it has not been as severely impacted as other advanced economies. The SNB mirrored the U.S. Federal Reserve Bank by further relaxing its monetary policy several times over the previous three months. SNB lowered the interest rate 50 basis points on November 6, 100 basis points on November 20, and 50 basis points on December 11 resulting in a current interest rate of 0.5% and a decrease of the target range for the three month Libor to 0 to 1 percent.

¶6. According to SNB Governing Board Chairman Jean-Pierre Roth, the reasons behind the monetary policy rest on three factors: 1) the international economic outlook deteriorated markedly, which negatively impacted forecasts for the Swiss economy; 2) the financial market crisis intensified; and 3) prices for raw materials and oil plummeted, which combined with the worsening economic outlook, led to a marked improvement in inflation and maneuvering room for the SNB.

Economic Stimulus Packages Announced

¶7. On November 12, the Federal Council announced the first economic stimulus package following the downward revisions of economic forecasts. The package envisioned to boost economic activity and employment involves an infusion of up to Sfr 1.5 billion ($1.2 billion) (0.2 percent of 2008 GDP). Immediate measures included Sfr 66 million to move natural hazard management projects forward, Sfr 20 million for federal civil construction projects, and Sfr45 million for residential construction. The GOS plans to lift a freeze on credits totaling Sfr205 million in January 2009, which will be directed toward transportation, education, farming and defense. Lastly, the GOS will pay back funds set aside as a crisis reserve paid into by 650 companies totaling Sfr550 million.

¶8. On December 21, the GOS announced a second stimulus package totaling Sfr650 million ($590 million). The package will be implemented in Spring 2009. Details regarding the use of the money have not been provided. The GOS has already indicated that a third stimulus package may be necessary if Switzerland does not recover by 2010.

Financial Crisis Impact on Swiss Banks

¶9. As reported in ref A, the GOS provided UBS, Switzerland's largest bank, a $60 billion rescue package that has been approved by Parliament. The SNB has now created a special purpose vehicle, the SNB StabFund, to acquire the illiquid assets of UBS. The first tranche of assets was acquired on December 16, whereby UBS transferred slightly over 2000 securities positions worth $16.4 billion. The majority of the assets were US and European residential and commercial mortgage backed securities. Speculation regarding further massive write-offs by UBS in the fourth quarter of 2008 lead to a 5 percent drop in UBS' stock on January 12, 2009.

¶10. CreditSuisse, Switzerland's second largest bank, avoided government intervention by boosting its capital Sfr10 billion through private investors. The capital infusion proved priceless when CreditSuisse needed to write off Sfr3 billion in losses in the fourth quarter of 2008.

Executive Bonuses at Risk

¶11. UBS executives voluntarily agreed to forgo their bonuses following UBS' request for GOS assistance and the bank's massive write-offs. In November, UBS former Chief Executive Peter Wuffli said he would forgo his Sfr12 million bonus. Following suit, former Chairman Marcel Ospel, Vice-President Stephan Haeringer and former Finance Chief Marco Sutor agreed to waive their bonuses worth Sfr 33 million. UBS announced a

revised bonus structure so that future bonuses will be paid only upon reaching long-term results.

¶12. Regardless of UBS' new bonus system, a general outcry from the public for the government to restrict CEO bonuses continues to support the popular initiative "Against fat-cat salaries", which was submitted to the government on February 26, 2008. The initiative would outlaw golden parachutes, golden handshakes, and bonuses, and require the annual general meeting to vote on total pay awarded to executives. On December 5, the Federal Council responded to the initiative by issuing a comprehensive bill revising the company and accounting law as an indirect counter-proposal. The bill is more moderate that the public initiative. The Federal Council requested parliament approval of its bill over the initiative. According to the Federal Council, its revisions would "result in balance between the various governing and executive bodies in a company, create sufficient transparency in the pay packages awarded to top managers, as well as in internal processes, and instigate measures to secure the position of shareholders as the company's owners." The bill provides greater protection to shareholders' assets by requiring fees paid to directors to be approved at the company's annual general meeting.

Lessons Learned: New Regulations

¶13. SNB's Governing Board Vice Chairman Philipp Hildebrand commented that the "financial system needs to be more resilient to possible shocks." The SNB has focused on the need to improve the "shock absorbers": capital and liquidity by implementing regulatory reforms. According to Hildebrand, both of the regulatory measures are in line with proposals made by the Financial Stability and the G20 action plan, a well as the strategy of the Basel Committee on Banking Supervision for implementing lessons from the crisis. He noted that the regulations are intended to supplement Basel II, not to replace it.

¶14. New Capital Adequacy Regulation: The Swiss Federal Banking Commission's reform of the capital adequacy regulation for big banks is designed to increase risk-weighted capital together with the introduction of a leverage ratio. The regulation will require big banks to increase risk-weighted capital. During upswings, banks will be required to considerably exceed the minimum requirements for capital and leverage ratios to ensure a buffer exists to absorb losses during crises. Banks will not be required to comply with the higher risk-weighted capital ratio and leverage ratio until 2013 to allow the banks to recover from the current crisis before implementation.

¶15. Liquidity Ratio: New regulations are in the process of being drafted to address inadequate liquidity. According to Hildebrand, the two big Swiss banks were hit particularly hard by the financial crisis to a large extent as a consequence of their extraordinarily high leverage. De-leveraging amplified the shocks to the financial system. The objective of the new regulation is "to obtain higher liquidity buffers that better reflect the great complexity of liquidity risks. When calculating liquidity requirements for various crisis scenarios, the authorities use internal model calculations by the banks. In order to ensure the comparability and transparency of the internal calculations, the new regime foresees certain standardisations." The conclusion of the project is scheduled for early 2009.

Comment

¶16. Although Switzerland has not yet been effected by the global financial crisis and economic slowdown to the same degree as other advanced economies, the GOS is taking every measure to lessen the eventual impact. With the majority of Swiss exports and imports reliant on the EU and US markets,

the GOS will continue to monitor these economies closely and likely adjust internal regulations and stimulus packages in response to any further deterioration in either economy.
CARTER